Supreme Court, U.S.
FILED
MAY 25 1999
CLERK

(2)

No. 98-1618

In the Supreme Court of the United States

PATRIOT PORTFOLIO, LLC, PETITIONER

v.

HARRY W. WEINSTEIN, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

The brief for the United States will address the following question:

Whether 11 U.S.C. 522(f)(1), a provision of the Bankruptcy Code that authorizes debtors to avoid judicial liens against property exempted from the bankruptcy estate, effects an unconstitutional taking of property when the judicial lien at issue was created after the lien-avoidance provision had been enacted.

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-26a) is reported at 164 F.3d 677. The opinion of the district court (Pet. App. 28a-35a) is reported at 217 B.R. 5. An earlier opinion of the district court (Pet. App. 39a-41a) is unreported. The opinions of the bankruptcy court (Pet. App. 36a-38a, 42a-44a, 45a-56a) are unreported.

JURISDICTION

The court of appeals entered its judgment on January 7, 1999. The petition for a writ of certiorari was filed on April 7, 1999. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. When a debtor files for bankruptcy, an estate arises that consists of all of the debtor's interests in property at the time of filing, together with "those interests recovered or recoverable through transfer and lien avoidance provisions." *Owen* v. *Owen*, 500 U.S. 305, 308 (1991); see also 11 U.S.C. 541. Section 522 of the Bankruptcy Code allows the debtor to exempt particular types of property from the bankruptcy estate. 11 U.S.C. 522(b). Exempt property is generally not subject to distribution to creditors, but is retained by the debtor as he or she makes a fresh financial start. 11 U.S.C. 522(c). Unless a State prohibits its debtors from invoking the exemptions specified under the Bankruptcy Code, a debtor may choose to exempt either the items of property listed in Section 522(d) or whatever property is exempted by state law and by federal non-bankruptcy law. 11 U.S.C. 522(b).

Section 522(f) of the Bankruptcy Code was enacted in 1978 as part of the Bankruptcy Reform Act. See Pub. L. No. 95-598, 92 Stat. 2589.[1] Section 522(f) permits a debtor to "avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled." 11 U.S.C. 522(f). It "protects the debtor's exemptions, his discharge, and thus his fresh start by permitting him to avoid certain liens on exempt property." H.R. Rep. No. 595, 95th Cong., 1st Sess. 362 (1977). Judicial liens are included among the liens

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[1] Congress amended Section 522(f) in 1994 to exclude from the scope of the debtor's avoidance power certain liens incurred in connection with divorce and separation proceedings. See Pub. L. No. 103-394, § 304(d), 108 Stat. 4133 (codified at 11 U.S.C. 522(f)(1)(A)).

subject to avoidance under Section 522(f). 11 U.S.C. 522(f)(1)(A).

2. In October 1986, Harry W. Weinstein executed a promissory note in favor of Guaranty First Trust Company (Guaranty). Pet. App. 46a. Weinstein defaulted on the note, and in April 1992 Guaranty secured a judgment against him. *Ibid.* In August 1992, Guaranty caused the execution of the judgment to be levied against Weinstein's interest in his residence, thereby perfecting its judicial lien. *Ibid.*; see *id.* at 5a, 24a. The Federal Deposit Insurance Corporation subsequently acquired Guaranty's lien against the residence and later assigned its interest in the judgment and execution to petitioner Patriot Portfolio, LLC. *Id.* at 47a.

In April 1996, Weinstein recorded a declaration of homestead under Massachusetts law. Pet. App. 5a. In August 1996, he filed for bankruptcy. *Ibid.* Weinstein chose the state exemptions rather than the exemptions listed in the Bankruptcy Code, and he asserted a homestead exemption in his schedule of exempt property. *Id.* at 46a. Petitioner objected to the homestead exemption, arguing that the Massachusetts law did not exempt property that was encumbered by debt incurred before the declaration of homestead was recorded. *Id.* at 47a.

The bankruptcy court initially agreed with petitioner that Section 522(f) was inapplicable because the homestead estate created under the Massachusetts statute does not include property encumbered by pre-existing debt. Pet. App. 45a-55a. The court subsequently reconsidered the question, however, and held that petitioner's lien was subject to avoidance under Section 522(f). *Id.* at 42a-44a.

3. Petitioner appealed to the district court, arguing both that the bankruptcy court had misapplied the

Bankruptcy Code to the state-created exemption, and that if Section 522(f) authorizes the avoidance of petitioner's lien, it effects an unconstitutional taking of petitioner's property. Pet. App. 29a, 35a n.2. The United States intervened pursuant to 28 U.S.C. 2403(a) to defend the constitutionality of Section 522(f). The district court affirmed the judgment of the bankruptcy court, holding that petitioner's lien should be avoided under Section 522 because the Bankruptcy Code preempts any inconsistent state law provisions. Pet. App. 32a. The district court declined to rule upon petitioner's constitutional challenge to the lien-avoidance provision. The court found that petitioner had waived its takings claim by failing to present that argument to the bankruptcy court, either in its initial objections or in response to the bankruptcy court's final order. *Id.* at 32a-33a.

4. The court of appeals affirmed. Pet. App. 3a-26a. After rejecting petitioner's statutory arguments, see *id.* at 6a-20a, the court held that application of Section 522(f) to petitioner's lien did not effect a taking of property, see *id.* at 20a-24a.[2] The court explained that "[petitioner's] judicial lien was perfected in 1992, thirteen years after § 522(f) became effective in 1979." *Id.* at 24a. Because the lien was subject from its inception to the avoidance provision of Section 522(f), application of that provision did not disrupt petitioner's legitimate expectations so as to effect a taking of property. See *id.* at 23a-24a. The court also stated that its resolution of

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[2] Although the court of appeals did not expressly hold that petitioner had preserved its constitutional argument, the court found it "appropriate to address the merits of [petitioner's] constitutional claim despite the possible procedural default." Pet. App. 20a n.5.

the Fifth Amendment question was supported, though not compelled, by this Court's decision in *United States* v. *Security Industrial Bank*, 459 U.S. 70 (1982). See Pet. App. 22a.

ARGUMENT

The court of appeals held, *inter alia*, that application of 11 U.S.C. 522(f) to a lien created after Section 522(f)'s enactment did not effect a taking of property. That holding is correct and does not conflict with any decision of this Court or another court of appeals. The fourth question presented in the petition therefore does not warrant this Court's review.[3]

1. Several courts have held that application of Section 522(f) to liens created after that Section's enactment does not effect a taking of property. See, *e.g.*, Pet. App. 20a-24a; *In re Thompson*,,867 F.2d 416, 422 (7th Cir. 1989); *Webber* v. *Credithrift of America, Inc.*, 674 F.2d 796 (9th Cir.) (rejecting takings challenge where the liens avoided were created in the "gap" between the enactment of Section 522(f) and its effective date), cert. denied, 459 U.S. 1086 (1982); *Caruthers* v. *Fleet Finance, Inc.* (*In re Caruthers*), 87 B.R. 723, 727 (Bankr. N.D. Ga. 1988) (stating that "the courts are in accord in applying and using Section 522(f) to avoid liens created after the effective date of that section"; collecting cases); *Walkington* v. *Production Credit Ass'n* (*In re Walkington*), 42 B.R. 67, 75 (Bankr. W.D. Mich. 1984);

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[3] Petitioner also asserts (see Pet. 7-20) a variety of non-constitutional challenges to the court of appeals' ruling. The United States intervened in this case pursuant to 28 U.S.C. 2403(a) to defend the constitutionality of the lien-avoidance provision of the Bankruptcy Code, 11 U.S.C. 522(f). Accordingly, the United States addresses only the question whether the application of that statute to petitioner's lien effects a taking of property.

Dotson v. *Bradford* (*In re Bradford*), 6 B.R. 741, 743-744 (Bankr. D. Nev. 1980) (sustaining lien avoidance when the lien was "created several months after the passage of the new Bankruptcy Act and all parties were on notice of the possible effects of the law upon the transactions conducted"). Petitioner cites no contrary holding, and we are aware of none.

2. The court of appeals correctly rejected petitioner's takings claim. Property interests "are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Board of Regents of State Colleges* v. *Roth*, 408 U.S. 564, 577 (1972). Accord, *e.g.*, *Phillips* v. *Washington Legal Found.*, 118 S. Ct. 1925, 1930 (1998); *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1001 (1984). For purposes of the Just Compensation Clause, the term "property" denotes "the group of rights inhering in the citizen's relation to the * * * thing, as the right to possess, use and dispose of it." *Id.* at 1003.

A lien is a legal interest created under the governing body of state and federal law, including the Bankruptcy Code. Since the enactment of the Bankruptcy Reform Act of 1978, the Code has provided that a judicial lien does not extend so far as to impair a debtor's chosen exemptions. See 11 U.S.C. 522(f)(1) ("the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled"). Petitioner's judicial lien was perfected in 1992, well after the enactment of the lien-avoidance provision. See Pet. App. 24a ("at its inception, [petitioner's] lien was subject to and limited by the debtor's power to avoid the lien under § 522(f)"). Because

potential defeasibility in bankruptcy was a limitation inherent in petitioner's original property interest, application of Section 522(f) to petitioner's lien did not disrupt petitioner's reasonable expectations so as to effect a taking of property. Compare *Monsanto*, 467 U.S. at 1006-1010 (governmental use and disclosure of trade-secret information submitted by private party did not effect a taking where the law in effect at the time of the private party's submission imposed no bar to such use and disclosure).

3. In *United States* v. *Security Industrial Bank*, 459 U.S. 70 (1982), this Court held that Section 522(f) does not apply to liens that attached before the enactment of the Bankruptcy Reform Act. *Id.* at 74-82. The Court expressed "substantial doubt" whether Section 522(f) could constitutionally be applied to such liens. *Id.* at 78. "[I]n the absence of a clear expression of Congress' intent to apply § 522(f)(2) to property rights established before the enactment date," the Court "decline[d] to construe the Act in a manner that could in turn call upon the Court to resolve difficult and sensitive questions arising out of the guarantees of the Takings Clause." *Id.* at 82 (internal quotation marks omitted). Although the Court had no occasion to resolve the question definitively, its analysis—and, in particular, its conclusion that Section 522(f) should be limited to subsequently-created liens in order to avoid "difficult and sensitive [Just Compensation Clause] questions"—strongly suggests that application of Section 522(f) to petitioner's lien poses no substantial constitutional difficulty.

In *United States* v. *Rodgers*, 461 U.S. 677 (1983), this Court upheld a federal statutory provision that authorized the judicial sale of property to satisfy tax liens. This Court cited *Security Industrial Bank* for the

proposition that "[i]f there were any Takings Clause objection to [the statute], such an objection could not be invoked on behalf of property interests that came into being after enactment of the provision." *Rodgers*, 461 U.S. at 697 n.24. The Court thus reaffirmed that the potential constitutional difficulties associated with retroactive abrogation of property rights do not arise in the context of rights created at a time when the challenged statute (or its equivalent) was part of the governing law.

CONCLUSION

With respect to the fourth question presented, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1999